

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

77-4098

Signed

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

FON S. LEONG and EILEEN LEONG,

Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellee

ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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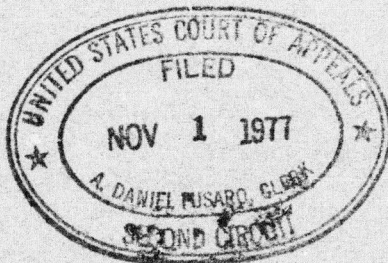


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STATEMENT OF THE ISSUES PRESENTED

1. Whether the Tax Court correctly decided that, in a case in which the taxpayers had the burden of proof, the Commissioner had no obligation to establish a likely source of unreported income in order to reconstruct income by the bank deposits method.

2. Whether the Tax Court properly affirmed the Commissioner's determination that the taxpayers' unexplained bank deposits represented unreported taxable income where the taxpayers themselves drew the issue by asserting a specific nontaxable receipt as the source of the bank deposits and where the Tax Court found this explanation unworthy of belief.

STATEMENT OF THE CASE

This is an appeal by the taxpayers, Fon S. Leong and Eileen Leong, from the decision of the United States Tax Court (Judge Tannenwald) sustaining the Commissioner's determination of deficiencies in the taxpayers' income taxes for the taxable years 1968 and 1969 in the respective amounts of \$26,161.03 and \$24,685.21, together with negligence penalties under Section 6653(a) of the Internal Revenue Code of 1954 (26 U.S.C.) in the respective amounts of \$1,308.05 and \$1,234.26. (R. 21.)^{1/} The opinion of the Tax Court is reported at 36 T.C.M. 89. The decision of the Tax Court was entered on January 31, 1977, and the taxpayers filed a timely notice of appeal on April 29, 1977. (R. 19.) The jurisdiction of this Court is invoked under Section 7482 of the Internal Revenue Code of 1954.

The facts, as found by the Tax Court, and as shown by the record, are as follows:

During the taxable years 1968 and 1969, the taxpayers operated the Canton Restaurant, which was located on Mott Street in New York City. (R. 21-22, 54.) The taxpayers also purchased and sold securities, using two brokerage accounts for this purpose in 1968, and eight such accounts in 1969. (R. 23, 44-45.) Finally, the taxpayers made deposits in eight different savings accounts during 1968 and in 10 different savings accounts during 1969. (R. 44-45.)

^{1/} "R." references are to the record appendix, which was bound together with the appellants' brief and paginated consecutively therewith. Other references are to the original record on appeal.

On their federal income tax returns, the taxpayers showed income from the following sources (R. 23):

	<u>1968</u>	<u>1969</u>
Net profit from restaurant	\$13,223.75	\$13,282.05
Dividends ^{1/}	1,707.37	1,537.62
Interest	2,712.50	2,891.47
Net gain (or loss) from sale or exchange of property ^{2/}	24,682.96	(2,249.98)

¹
Before any statutory exclusion and exclusive of nontaxable dividends.

²
Before any segregation of short-term and long-term gain and before any deduction for long-term capital gain.

In his statutory notice of deficiency, issued November 23, 1973, the Commissioner determined that the taxpayers had realized unreported income in the amount of \$47,893.12 in 1968 and \$47,272.23 in 1969. (Pet. Ex. A, p. 4.) This determination was based on the net deposits (i.e. the excess of the aggregate deposits over the aggregate withdrawals) in the taxpayers' checking, savings and brokerage accounts for each year in question. (R. 24, 36, 44-45.)

At the trial, the taxpayers testified that in 1967 Ping Chung Leong, a relative of Fon Leong, came to the United States from Hong Kong, and, on his arrival, he entrusted \$50,000 in cash

to the taxpayers for safekeeping. (R. 25; Tr. 25-28, 97-98.) Fon Leong testified that Ping Chung Leong, whom he had not seen since he left Hong Kong for the United States approximately 16 years earlier, visited him at his restaurant on the day after Ping Chung Leong arrived in New York in 1967, and that on this occasion Ping Chung Leong handed him \$50,000 and asked him to keep it while they both looked for an investment opportunity, such as a restaurant business, in which Ping Chung Leong could use the money. (Tr. 92, 96-98.) Fon Leong did not count the money at the restaurant, but he "glanced at it" and took it home to his wife. (Tr. 97-99.) Eileen Leong testified that she took the money when her husband gave it to her and placed it in a small metal box in a drawer in the bedroom. (Tr. 42-44.) She did not count the money at that time, but she did count it later, and determined that the stack of hundred dollar bills delivered to her on this occasion contained \$50,000. (Tr. 27, 42-45.) Later that year, Eileen Leong took about \$25,000 of this money and placed it in her safe deposit box. (Tr. 30, 51-52.) She explained that she kept half the money at home rather than putting it all in the safe deposit box because she thought that Ping Chung Leong might need a part of his money in a hurry if an investment opportunity arose. (Tr. 52.)

Eileen Leong also testified that sometime later, apparently beginning in 1968, she began removing portions of this cash from her safe deposit box and depositing them in her checking account. (Tr. 31-32, 55-56.) She then drew checks against these deposits and used the checks to pay for stock purchases made through various

brokerage firms. (R. 44-45; Tr. 31-33.) These securities were purchased in the names of the taxpayers, Fon and Eileen Leong, and Ping Chung Leong never asked for, or received, any share of the profits and losses from these investments. (Tr. 32-33, 128-129.)

Eileen Leong also testified that in February, 1969, Rosita Fu, a friend of hers, gave her \$50,000 in hundred dollar bills. (Tr. 61-62, 64, 70.) This money, like the money from Ping Chung Leong, was supposedly being entrusted to Eileen Leong for safe-keeping, and she put it in the metal box in her bedroom, together with what was left of the money from Ping Chung Leong.^{2/} This money was supposedly delivered to Eileen Leong as Rosita Fu's share of a proposed real estate investment (Tr. 61), but Eileen Leong and Rosita Fu never did go ahead with the proposed venture "because the property cost too much" (Tr. 65). Eileen Leong testified that she did discuss the purchase of several buildings, and on one occasion Rosita Fu went with her to look at a building on East Broadway, but nothing came of any of these discussions. (Tr. 65-66, 79-83.) During 1969, Eileen Leong used the money she was supposedly holding for Rosita Fu to pay for her own securities purchases, just as she had previously done with Ping

^{2/} Although Eileen Leong testified that she began taking the money for her stock purchases out of the cash in her safe deposit box (Tr. 55-56), apparently because she felt that the funds which she had retained at home in the metal box in her bedroom, amounting to about \$25,000, seemed adequate to meet any unexpected demand by Ping Chung Leong for the return of his funds (Tr. 52, 56), her urge to invest in the stock market was evidently strong enough so that in 1968 she found it necessary to raid her metal box, as well as her safe deposit box, in order to pay for her stock purchases (Tr. 58). By February, 1969, when she claims that she put Rosita Fu's money in the metal box, there was "very little" of Ping Chung Leong's money left, probably between \$1,000 and \$5,000. (Tr. 76-77.)

Chung Leong's money. (R. 66.) She testified that she did not consider that any part of the profits from these investments belonged to Rosita Fu, nor did she consider that the money was a loan to her. (Tr. 66, 77, 86.) Rosita Fu, who had graduated from college in Hong Kong, and had been employed as a legal secretary both in Hong Kong and in New York (R. 26; Tr. 151-152, 165), testified that she did not expect to receive any interest on the money she gave to Eileen Leong, nor did she expect to share in any of the profits or losses which Eileen Leong might obtain by investing this money in stocks and bonds (Tr. 163-164).

After the notice of deficiency in this case had been issued, Eileen Leong made two \$5,000 payments, dated May 20, 1974, and January 6, 1975, respectively, to Rosita Fu, ostensibly in partial repayment of the funds entrusted to Eileen Leong in February, 1969. (R. 18; Tr. 66-69, 83-85.) On June 20, 1974, Fon Leong paid \$10,000 to Ping Chung Leong, ostensibly as a partial repayment of the funds entrusted to him by Ping Chung Leong in January, 1967. (Tr. 99-100, 103.) All three of these purported repayments were made by check (Pet. Ex. 9, 10, 11), despite the fact that all the funds supposedly entrusted to Fon and Eileen Leong had been paid to them in cash (Tr. 26-27, 61-62), and despite Eileen Leong's claim that, at least at the outset, she had kept \$25,000 of Ping Chung Leong's money in cash in a metal box in her bedroom instead of taking it to her safe deposit box because she was concerned about the possibility that Ping Chung Leong might need some of his funds in a hurry and she would have no opportunity to get to the bank (Tr. 52).

The Tax Court rejected the testimony offered by the taxpayers in support of their explanation of the source of their net deposits on the ground that it was so unreasonable as to be unworthy of belief. (R. 33-34.) The Court then concluded that the taxpayers had not sustained their burden of showing that the Commissioner's determination was erroneous and entered a decision in favor of the Commissioner. (R. 19, 34.) From this decision the taxpayers bring this appeal.

ARGUMENT

THE TAX COURT PROPERLY AFFIRMED THE COMMISSIONER'S DETERMINATION THAT THE TAXPAYERS' UNEXPLAINED BANK DEPOSITS REPRESENTED UNREPORTED INCOME WHERE THE TESTIMONY OFFERED IN SUPPORT OF THE TAXPAYERS' ATTEMPT TO ESTABLISH A PARTICULAR NONTAXABLE SOURCE FOR THESE DEPOSITS WAS FOUND TO BE WHOLLY UNWORTHY OF BELIEF

The taxpayers apparently concede (Br. 11) that they have the burden of proof in this case. In any event, it is well established that when the Commissioner has determined that a taxpayer's unexplained bank deposits represent amounts includible in gross income, the taxpayer has the burden of showing that that determination was wrong. Jones v. Commissioner, 29 T.C. 601, 613-614 (1957); Estate of Mason v. Commissioner, 64 T.C. 651, 656-657 (1975). See Rule 142(a) of the Rules of Practice and Procedure of the United States Tax Court (Jan. 1, 1974). Here the taxpayers sought to discharge their burden by presenting testimony to establish that the bank deposits in question represented piecemeal deposits of two cash hoards of \$50,000 each which had been entrusted to them by a relative of taxpayer Fon Leong and a friend of taxpayer Eileen Leong, respectively. (R. 29-32.) The Tax Court rejected this testimony as unworthy of belief, pointing out that it "would strain credulity beyond any reasonable limits" to accept the taxpayers' explanation that each of the two supposed owners of the money had given \$50,000 in cash to the taxpayers for safe storage in a dresser drawer or for the taxpayers to use as they saw fit. (R. 32-34.) Taxpayers state (Br. 3) that they do not challenge the supportability of that

finding. Therefore, it is conceded for purposes of this appeal that the taxpayers' assertion of a particular nontaxable receipt as the source of the deposits in question was untrue.

Having thus rejected as not credible the evidence offered by taxpayers in their attempt to meet their burden of proof, the Tax Court had no alternative but to sustain the Commissioner's determination. As this Court pointed out in Estate of Hague v. Commissioner, 132 F. 2d 775, 777 (1943):

It has not been uncommon to use bank accounts as evidence of the receipt of income * * * While such evidence, of course, is not conclusive, deposits in checking accounts are so often made up of income that where, as here, that is the fair inference to be drawn from the facts it was proper to give it effect.

Even in a criminal case based on the net worth method, where the circumstantial nature of the net worth method of proof, and the corresponding danger of an unjust conviction, led the Supreme Court to state that the Government must prove a likely source of taxable income from which the net worth increases might have been derived, Holland v. United States, 348 U.S. 121, 127-129, 137-138 (1954), such proof need not be offered if the Government is able to negate all nontaxable sources which might account for the increases. United States v. Massei, 355 U.S. 595 (1958). Moreover, as the court pointed out in Commissioner v. Thomas, 261 F. 2d 643, 646 (C.A. 1, 1958):

* * *this burden of negating is not so broad as it sounds, for although this case has been in litigation before the Tax Court and us for five and one-half years, the only source of nontaxable income which the taxpayers have contended accounts for taxpayers' increases in net worth * * * was a substantial cash gift from Mrs. Thomas' father. It follows that in this case only that source needs to have been negated.

Similarly, in Gatling v. Commissioner, 286 F. 2d 117, 144 (C.A. 4, 1961) the court noted with respect to the Commissioner's alternative (to showing a likely taxable source) burden of negating nontaxable sources.

Where taxpayer has committed himself to one specific explanation of the source * * *, the Government should not be required to waste time and resources futilely attempting to negate possible nontaxable sources which have, in effect, been denied by taxpayer's claim of a particular source.

Thus, even if the Commissioner had had some duty to show the probability that the bank deposits had come from a taxable source, that burden was fully met by the Commissioner's cross examination of the taxpayers' witnesses and his demonstration, to the satisfaction of the Tax Court, that the story of the two cash hoards supposedly entrusted to the taxpayers by Ping Chung Leong and Rosita Fu was unworthy of belief. The taxpayers committed themselves to this explanation of the source of their otherwise unexplained deposits, and, having failed to carry their burden of persuading the Tax Court of the truthfulness of their explanation, they could not now complain (even in a criminal case) that Commissioner failed to establish a likely taxable source of the funds.^{3/}

^{3/} In any event, the taxpayers' contention (Br. 5) that the Commissioner somehow "elected" to show that the taxpayers' restaurant was a likely source of the deposits in question in this case is wrong. The testimony of the revenue agent concerning the income producing capacity of the taxpayers' restaurant was brought out on cross examination by taxpayers' counsel (Tr. 188-190), apparently for the purpose of demonstrating, by way of the revenue agent's opinion, that the restaurant business could not have generated the amount of income involved in this case (Tr. 190). Subsequently, on redirect examination, Government counsel sought to clarify this testimony and bring out the fact that, after further consideration, the revenue agent had concluded that the taxpayers' restaurant could have generated the income. (Tr. 192-194.) This hardly constitutes an "election" by the Government to rest its case upon an attempt to prove that the restaurant was a likely source for the unreported income.

CONCLUSION

For the reasons stated, the decision of the Tax Court should be affirmed.

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OCTOBER, 1977.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 26th day of October, 1977, in an envelope, with postage prepaid, properly addressed to him as follows:

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